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C O N F I D E N T I A L SECTION 01 OF 03 TOKYO 002464

SIPDIS

STATE FOR E, EEB AND EAP/J
NSC FOR DANNY RUSSELL AND JIM LOI
USTR FOR AUSTR CUTLER, BEEMAN, LEE AND HOLLOWAY

E.O. 12958: DECL: 10/23/2019

TAGS: ECON EFIN PGOV JA

SUBJECT: HATOYAMA CABINET STRUGGLES TO HOLD DOWN FY10
BUDGET - MINISTERIAL REQUESTS REACH RECORD 95 TRILLION YEN

REF: A. TOKYO 2397
1B. TOKYO 2443

Classified By: Ambassador John V. Roos; Reasons 1.4 (B) and (D).

SUMMARY

¶1. (C) The Hatoyama Cabinet completed a key step in the compilation of the FY10 budget with the submission to the Ministry of Finance (MOF) of budget requests from individual ministries and agencies. FY10 general account budget requests reached a record JPY 95 trillion (USD 1.1 trillion), 7 percent more than the FY09 initial budget. Most of this increase reflected new spending initiatives included in the DPJ's "manifesto" (policy platform) for the August 30 Lower House election. The Hatoyama Cabinet also decided to suspend approximately JPY 2.9 trillion (USD 32 billion), or about 20 percent of the spending in former Prime Minister Aso's FY09 supplemental budget passed last May. It will be very difficult for the Hatoyama Administration to fully fund the policy measures in its manifesto without increasing JGB issuance in FY10.

The Budget Process

¶2. (SBU) The Government Revitalization Unit (GRU), with the help of MOF, will now examine these budget requests and finalize each ministry's budget by end-December. (Note: The GRU, also known as the Administrative Reform Council, is tasked with identifying wasteful government spending. Chaired by Prime Minister Hatoyama, it comprises eleven members - six Cabinet ministers and five private-sector members. End Note.) Administrative Reform Minister Sengoku has stated that the DPJ will seek to keep the overall size of the FY10 general account budget to JPY 92 trillion, meaning a cut of JPY 3 trillion. There will also be an intense focus on the financing side, including the amount of required Japanese government bond (JGB) issuance. Revenue estimates for FY10 will be developed by mid-December. Finance Minister Fujii continues to stress that FY10 JGB issuance will be capped at JPY 44 trillion, while admitting that FY09 JGB

issuance may total a record JPY 50 trillion due to fiscal stimulus and faltering tax revenues.

Breakdown of FY10 Budget Requests

¶3. (SBU) The Hatoyama Cabinet's budget guidelines required individual ministries to submit their FY10 budget requests to MOF by October 15. (Note: The Hatoyama Cabinet's guidelines called for compiling the initial FY10 budget by end-December, while scrapping the previous budget request guidelines of the Aso Cabinet. End Note.) FY10 general account budget requests reached a record high of JPY 95 trillion (USD 1.1 trillion), an increase of 7 percent over the initial FY09 budget. Excluding two mandated spending items--debt service costs, and revenue sharing with local governments--ministerial budget requests totaled JPY 55 trillion, or 6 percent more than the initial FY09 budget.

¶4. (SBU) The bulk of this increase stems from policy initiatives in the DPJ's manifesto for the August 30 Lower House election. The DPJ budgeted roughly JPY 4.4 trillion (USD 49 billion) for manifesto-related policy measures (see table below). This is actually less than the JPY 7.1 trillion required to fully implement those measures in FY10. The difference of about JPY 2.7 trillion is mainly due to: (1) the absence of the DPJ's proposed abolishment of surcharge taxes on gasoline and automobiles (JPY 2.5 trillion), and (2) a monthly child allowance program is now estimated to cost JPY 0.4 trillion less in FY10 than

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expected. (Note: The abolishment of the gasoline and automobile surcharge is a financing, not expenditure proposal and so was not expected to be included in the budget. End Note.)

¶5. (SBU) FY10 debt service costs are estimated at JPY 22 trillion (USD 243 billion), an 8 percent increase from the FY09 initial budget. Revenue sharing with local governments is projected to rise 5 percent to JPY 17 trillion (USD 193 billion). The FY10 budget requests also include the repayment of JPY 0.7 trillion (USD 8 billion) borrowed in FY08 as a temporary measure from the debt consolidation special account. In addition, requests falling under the Fiscal Investment and Loan Program (FILP), the so-called "second budget", totaled JPY 19 trillion (USD 211 billion), up 20 percent from initial FY089 FILP requests.

Review of the FY09 Supplemental Budget

¶6. (SBU) In parallel with the compilation of the FY10 budget, the Hatoyama Cabinet conducted a four-week review of spending in the FY09 supplemental budget. (Note: On May 29, the Diet approved a FY09 supplemental budget compiled by the previous Aso Cabinet to finance JPY 15 trillion (USD 163 billion) in spending committed under the April economic stimulus package. End Note.) On October 16, the new Cabinet decided to

suspend roughly JPY 2.9 trillion (USD 32 billion, or 0.6 percent of GDP) in spending. This figure--slightly short of the unofficial target of JPY 3 trillion (USD 33 billion)--accounted for nearly 20 percent of the total spending authorized in the supplemental budget. Finance Minister Fujii has stated that the DPJ would decide what to do with the savings in December, noting that it could be used for policy measures in the DPJ manifesto or for a reduction in JGB issuance. The suspension of the spending will weaken the expected fiscal stimulus of the FY09 supplemental budget.

The suspended disbursements notably include JPY 0.8 trillion (USD 9 billion, or 0.2 percent of GDP) in public works projects and equipment purchases.

(U) DPJ's Policy Measures Earmarked Under Budget Requests for FY10 (JPY trillion)

a. New monthly child allowance program	2.3
b. Elimination of some highway tolls	0.6
c. Income support program for rice farmers	0.6
d. Free high school tuition fees	0.5
e. Employment measures	0.3
f. Follow-up on pension recordkeeping problem	0.1
TOTAL	4.4

(U) Comparison of FY09 Initial and FY10 Budgets

	FY09 Initial Budget	FY10 Initial Budget	Change from FY09 Requests (percent)
	(JPY trillion)		
General Account Budget			
TOTAL	88.5	95.0	7.3
a. Ministerial Budget	51.7	55.0	6.3
b. Debt Service Costs	20.2	21.9	8.1
c. Revenue Sharing with local Governments	16.6	17.4	5.2
d. Repayment of Borrowing for FY08 Settlement Fund	0.0	0.7	n/a
Fiscal Investment and Loan Program Total	15.9	19.0	19.5

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(U) Breakdown of Suspended Spending in FY09 Supplemental Budget (JPY trillions)

a. Financial Measures (e.g. capital infusion into government affiliated banks)	0.6
b. Public Works	0.5
c. Local Governments	0.4
d. Purchase of Equipment	0.3
e. Others	1.1
TOTAL	2.9

(U) FY10 Budget Calendar

Mid-October	- Ministries submit spending requests to MOF.
Mid-October to Early December	- Spending requests are analyzed and negotiated between ministries and the GRU.
Mid-December	- Tax revenue estimates are set, and the amount of JGB issuance is decided.
Late December	- The Cabinet approves the FY10 budget.
Late January	- The FY10 budget is submitted to the Diet.
February to March	- The FY10 budget is debated and passed by the Lower House and Upper House of the Diet.

COMMENT

¶7. (C) While the Hatoyama Administration continues to insist that it will both fully implement its manifesto proposals and hold JGB issuance to ¥44 trillion in FY10, hard choices likely await. Worse than expected FY10 tax revenues and/or insufficient funding in the special accounts would force a decision between either implementing only certain of the

economic policy measures laid out in the manifesto or
increasing JGB issuance despite a public commitment not to.
End Comment.

ROOS